ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author:	Richman	Analyst:	Deborah Barrett	Bill Number:	AB 2450
Related Bills:	See Legislative History	Telephone:	845-4301	Introduced Date:	February 23, 2006
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: FTB To Retain From Any Income Tax Overpaid Amount Required To Obtain Minimum Health Care Coverage From Purchasing Exchange/Department of Insurance, Department of Health & FTB Develop Program To Verify Resident's Compliance

SUMMARY

This bill would require Franchise Tax Board (FTB) to do the following:

- Intercept income tax refunds as payment for health care premiums, and
- Cooperate with Department of Health Services (DHS) and Department of Insurance (DOI) to verify compliance with the provisions of this bill.

This bill contains additional provisions related to the administration of the Cal-Health Act and provides for a premium tax to be imposed on health care insurance providers to assist in funding a mandatory health coverage program. Neither of these provisions impact the department's operations or programs and are not discussed in this analysis.

PURPOSE OF THE BILL

According to the author's staff, the purpose of this bill is to address the uninsured health coverage gap currently in existence for California residents.

EFFECTIVE/OPERATIVE DATE

This bill would become effective and operative on January 1, 2007.

POSITION

Pending.

ANALYSIS

STATE LAW

Under current state law, the Controller has the discretion to offset any amount due a state agency from a person or entity against any amount owing that person or entity by any state agency.

Board Position:			Department Director	Date
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FTB administers the Interagency Intercept Program on behalf of the Controller. The Interagency Intercept Program requires, through an annual enrollment process, other state agencies and the IRS to provide FTB with a list of debtors and amounts owed to be offset in the following tax filing season. All participating agencies are charged an administrative fee to cover the cost of the Intercept Program. As returns are filed, and tax refunds issued, any refunds due the taxpayer are offset to satisfy the debts identified by the participating agencies.

In instances where multiple debts are owed, offsets are applied in the following priority:

(1) Nonpayment of child or family support requests
(2) Nonpayment of spousal support requests
(3) Overpayments of benefits administered by the Employment Development Department
(4) Other offset requests received from other state agencies
(5) Offset requests received from cities and counties
(6) Requests from private and post secondary education
(7) Internal Revenue Service requests

The offset program will maintain up to five offset requests per taxpayer and purges the file annually. There are approximately 250 entities participating in the current offset program.

Under current state law, taxpayers that itemize deductions on their state returns may use medical expenses that exceed 7.5% of their adjusted gross income to reduce their taxable income. Insurance premiums for health care coverage are included as medical expenses for purposes of this deduction.

THIS BILL

This bill would require FTB to intercept tax refunds of taxpayers who do not obtain the minimum required health care coverage and remit those funds to the applicable purchasing exchange to pay for the minimum coverage.

This bill would require FTB, in conjunction with the Department of Health Services (DHS) and the Department of Insurance (DOI), to develop a program to verify a resident's compliance with provisions of the Cal-Health Act enacted by this bill.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

- The bill requires California residents to obtain health care coverage from health care service plans that are regulated by the Department of Managed Health Care or covered through a health insurance policy regulated by the Department of Insurance. There are many California residents, such as military members and their families that are covered under federal health care programs that are not subject to state regulation. Under the provisions of this bill, the department would be required to withhold personal income tax refunds to purchase additional health coverage. It is suggested that an exception be included to allow residents with this type of health care coverage to meet the requirements under this bill.

- The current offset program requires the requesting agency to identify the taxpayer and outstanding debt and provide that information to FTB. To the extent that the offset requests would follow current offset program specifications, the implementation could be accomplished through the department's normal annual update.

- The bill does not identify how the verification program for taxpayer compliance would be completed. The author's staff has indicated a method for verification of compliance that is inconsistent with the department's expertise, current programs, and processes. If it is the author's intent that FTB implement this bill in a specific manner, language to that effect is suggested to ensure all involved agencies have a clear understanding of their intended roles and responsibilities. Until program specifics are determined, the department is unable to identify additional implementation issues that would need to be resolved.

- The timeline in which the author intends for the provisions of this bill to be completed is unclear. Although the bill is operative as of January 1, 2007, it is not clear when the offset of refunds for payments of premiums would begin. It appears that the majority of the bills provisions would need to be implemented before the department would be able to do any level of verification or intercept of refunds. It is recommended that the expected implementation timeline be clarified to ensure all departments are consistent with their planning efforts.

LEGISLATIVE HISTORY

AB 1670 (Nation 2005/2006) provided for a 3-part plan to require mandatory health care coverage, with taxpayers submitting evidence of the coverage with their state income tax return each year. This provision was deleted in an April 14, 2005 amendment. This bill failed passage in the Assembly Revenue and Taxation Committee.

OTHER STATES' INFORMATION

The states reviewed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York.* These states were selected due to their similarities to California's economy, business entity types, and tax laws. All of these states have provisions for the offset of tax refunds for payment of outstanding debts owed to other state agencies, child or spousal support, or federal liabilities. None of these states revealed information related to the administration of mandatory health coverage by the revenue agencies.

The state of Massachusetts recently enacted legislation that would require mandatory health care coverage of all residents. Mandated coverage would be verified by the Department of Revenue through filed tax returns, with enforcement actions that would range from denial of the personal exemption if coverage is not verifiable to the assessment of penalties equal to the cost of premiums for uninsured taxpayers. It is not clear how Massachusetts will enforce the mandated coverage for those who do not file tax returns.

FISCAL IMPACT

Assuming that the Department of Health Services is responsible for identifying and certifying the enrollment of California residents on an annual basis, departmental costs associated with adding this agency as an offset request can be accommodated in the normal annual update processes. To the extent that the verification program developed requires FTB to assume a lead implementation role, the department anticipates substantial system programming and development costs; processing, form change, and manual verification costs would be associated with this proposal. Department costs will be developed as specific language providing direction is provided and the bill moves through the legislative process.

ECONOMIC IMPACT

Revenue Estimate

Based on data and assumptions discussed below, this provision would result in the following revenue losses.

Estimated Revenue Impact of AB 2450 Effective for Tax Years BOA 1/1/2007 Assumed Enactment Date After 6/30/06		
($ in Millions)		
2006/07	2007/08	2008/09
Unknown	Unknown	Unknown

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Tax Revenue Discussion

The revenue loss from this proposal is unknown because the extent to which taxpayer behavior will be altered to use a tax-preferred method for acquiring or providing new health benefits is uncertain as explained below.

While this proposal would not change the income tax laws, it could cause taxpayers to alter their behavior in ways that would reduce their taxable income. For instance, if taxpayers purchase their own insurance, itemized deductions for medical expenses could increase. Employers could change the compensation structure by providing health benefits for previously uninsured employees.

While the proposal mandates that all Californians have health insurance, the only enforcement mechanism in this bill is the FTB intercept of tax refunds. The effectiveness of this mechanism would be limited because many Californians do not have an obligation to file an income tax return and many others do not receive tax refunds. In addition, the amount withheld from a taxpayer's paycheck can be adjusted to eliminate over withholding and a subsequent refund. Consequently, the enforcement mechanism alone is not likely to change taxpayer behavior.

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